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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 393

McLOUTH STEEL CORPORATION, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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THE UNITED STATES OF AMERICA, Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

McLouth Steel Corporation, your petitioner, prays that a writ of certiorari issue to review the judgment of the United States Court of Claims, entered in the above-entitled case on June 7, 1963.

OPINION BELOW

The opinion of the Court of Claims (Appendix A, pp. 13-22) has not yet been reported.

JURISDICTION

The judgment of the Court of Claims was made and entered on June 7, 1963 (App. 13-22). The jurisdiction of this Court is invoked under the provisions of 28 U.S.C.A. section 1255(1).

QUESTION PRESENTED

Are the two instruments issued by petitioner in 1953 to two insurance companies exempt from the documentary stamp tax?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in Appendix B, pp. 23-24.

STATEMENT

A. *The Basic Facts.* For purposes of this Petition we accept the basic facts stated in its opinion (App. 13-15) by the court below:

> "Sections 1800, 1801 of the Internal Revenue Code of 1939 impose an ad valorem documentary stamp tax on 'all bonds, debentures, or certificates of indebtedness issued by any corporation * * *.' We are called upon to determine whether two instruments issued by the taxpayer in 1953 are bonds within the meaning of this statute.

"The taxpayer, McLouth Steel Corporation, considered the instruments taxable in 1953, for it purchased and affixed the stamps at the time of their issuance. However, after the decision of the Supreme Court in *United States v. Leslie Salt Co.*, 350 U.S. 383 (1956), the taxpayer filed a claim for a refund, asserting that the instruments were not covered by the statute. The taxing authorities having rejected taxpayer's claim, the present action for a refund was filed in this court. The case is now before us on the Government's motion for a summary judgment.

"The instruments in question are each labelled a 'First Mortgage 4¼% Sinking Fund Bond,' and are identical in terms except as to amount and payee. One, with a face value of $30,000,000, and numbered No. R 000001, was issued to the Metropolitan Life Insurance Company; the second, with a face value of $26,000,000, numbered No. R 000002, was issued to The Prudential Insurance Company of America. They are issued in the name of the respective insurance companies and registered with the borrower, McLouth. The instruments are formal documents, printed on a steel engraved border, and issued under the seal of the taxpayer.

"Each instrument has a maturity of 19½ years, and carries interest of 4¼% in the unpaid balance, payable semi-annually. The instruments are each subject to the terms of both a 'Purchase and Loan Agreement' executed between McLouth and the insurance companies, and an 'Indenture of Mortgage and Deed of Trust' executed between McLouth and the National Bank of Detroit, as trustee. McLouth has the right to redeem the Bonds at any time upon the payment of a stipulated premium. The insurance companies have the right to demand that McLouth exchange their originally issued Sinking Fund Bonds in exchange for registered or coupon bonds in the same aggregate principal amount but in smaller denominations. The sinking fund provisions are set out in the indenture. Substantial re-

strictions upon McLouth's right to incur additional indebtedness and to pay dividends are also imposed by the indenture agreement.

"Contemporaneously with the issuance of the above Sinking Fund Bonds, McLouth also borrowed an additional $4,000,000 from each of the two insurance companies, evidenced by '5¼% Income Convertible Notes,' and $14,000,000 from certain banks, with the National Bank of Detroit as agent, under a 'Bank Loan Agreement.' The Sinking Fund Bonds and the bank loans are secured by property of the taxpayer under the indenture agreement, but the Income Convertible Notes are not covered by the indenture."

B. *The documentary stamp tax issue.* In opposing the Government's motion for summary judgment, the petitioner contended that two genuine issues of material fact existed: (1) Are the two instruments issued in series; and (2) Do the two instruments have the basic feature of an "investment security"; viz., marketability.

Action on petitioner's request for a trial date for the purpose of presenting the testimony of one expert witness was deferred by a commissioner of the Court of Claims upon his subsequent receipt from the Government of notice that it intended to file a motion for summary judgment. Petitioner opposed this motion and in support of such opposition filed an affidavit of its expert witness.

The court below has acknowledged the existence of material issues of fact, and in an apparent recognition of the rule set down in *Arthur S. Curtis v. United States*, 168 F. Supp. 213, 216 (Ct. Cl. 1958) that where no counter affidavit is filed in a motion for summary judgment the court may accept as true the statements in the affidavit submitted, has purported to accept as true the statements in the

affidavit of petitioner's financial expert that the two instruments are not "issued in series" as that term is understood in financial parlance (App. 16) and are not "marketable" as that term is generally understood (App. 17). However, it has nullified such acknowledgment and acceptance by substituting its own understanding of these terms for their generally understood meanings in holding that the two instruments are "issued in series" and are "marketable".

REASONS FOR GRANTING THE WRIT

The question presented is of great and recurring importance in the administration of the tax laws of the United States. By holding that petitioner is liable for a documentary stamp tax on the issuance of the two instruments, the court below has decided that even though the two instruments were not "issued in series" and even though the two instruments were not "marketable" as those terms are generally understood, the two instruments are taxable as "bonds" within the meaning of the statute. This result runs counter to applicable decisions of this Court, is in conflict with rulings in the circuits, and merits exercise of this Court's power of supervision.

A. Petitioner asserts that this Court has established that only those instruments are subject to the "debenture" tax which are issued (1) in series, (2) under a trust indenture and (3) in registered form or with coupons attached; in other words, that the tax applies only to marketable corporate securities as that term is generally understood. *United States v. Leslie Salt Co.*, 350 U. S. 383 (1956). As Mr. Justice John M. Harlan there said for the Court (350 U.S. at 393-394): "The essence of an 'investment security'

is, of course, marketability, and this basic feature the Leslie Salt notes did not have."

The definition given by the court below to "issued in series" as meaning issued with serial numbers (App. 16) attaches practically no significance to this essential feature of a marketable corporate security set forth by this Court in *Leslie Salt* (389-390) and discussed in the affidavit of petitioner's financial expert (R. 184-186). Rather, this definition given by the court below substitutes the presence of serial numbers (used for purposes of identification—(R. 186)) for one of the essential features of a marketable corporate security. Naturally, little significance attaches to this feature if what this Court in *Leslie Salt* meant by "issued in series" is the same as what the court below believed it to be; viz., issued with serial numbers. However, petitioner believes that this Court in *Leslie Salt* (397) in affirming the principles established in *United States v. Isham*, 84 U.S. (17 Wall.) 496 (1873), used the term "issued in series" as that term is generally understood by that public in which it is to take effect; viz., the financial community. This Court has thereby attached no less important significance to the essential "issued in series" feature than it has attached to the other two prescribed essential features of a marketable corporate security as that term is generally understood.

The marketability of a corporate security surely does not depend upon the absence or presence of serial numbers. However, it most certainly depends upon whether the instrument is issued in series as that term is used in financial parlance (R. 176-177, 184-186). The affidavit of petitioner's financial expert fully supports this interpretation.

Application of the definition given by the court below to "issued in series" as meaning issued with serial numbers

makes it impossible for a taxable single instrument to be issued by a corporation. Indeed, the issuance of only two instruments hardly falls within this "issued in numbers" variation of the definition. However, it is fully possible under the definition of "issued in series" as that term is understood in the financial community, for a single taxable instrument to be issued by a corporation.

The Court below (App. 16) recognized that "the use of a serial number is not what is meant in financial parlance by an issue 'in series'". It then considered only one of the two meanings of "issued in series" set forth in the affidavit submitted by petitioner (R. 184-186). By so doing it correctly reasoned (App. 16-17) that petitioner was contending that all sinking fund bonds should be immune from the documentary stamp tax. Petitioner is not contending.

The second meaning of "issued in series" as that term is generally understood (R. 185) encompasses sinking fund bonds. However, such an issue of sinking fund bonds must be under an "open-end" indenture as opposed to petitioner's single sinking fund term issue. Under an "open-end" indenture the first series is generally issued under the underlying indenture and subsequent series are issued within the limitations of the underlying indenture through supplements thereto which may and usually do provide for different maturities, interest rates, sinking funds and redemption features for each new series as compared with series previously issued.

The court below said "we deem it of no consequence that the Bonds were not issued serially" (App. 17).

Such an approach ignores the clear thrust of *Leslie Salt*. In that case this Court did not "suggest", as stated by the court below (App. 15), but specifically set forth the features required of a taxable instrument. In doing so, recog-

nition was given to the essential features of a marketable corporate security as that term is generally understood. All three features must be present in order to qualify the instrument as marketable as that term is generally understood. Absence of any one feature disqualifies the instrument as a marketable corporate security as that term is generally understood. Yet the court below deemed it of no consequence that the instruments were not issued in series (one of the three essential features) and laid particular stress on the existence of the trust indenture (one of the three essential features). (App. 17, 21).

The decision in *Leslie Salt* has superimposed technical tests of taxability on the language of the statute within the scope of the rule stated in *Isham* (504) and reaffirmed in *Leslie Salt* (396) that "the liability of an instrument to a stamp duty, as well as the amount of such duty, is determined by the form and face of the instrument, and cannot be affected by proof of facts outside of the instrument itself." The decision in *Isham* also provides at page 504: "The words of the statute are to be taken in the sense in which they will be understood by that public in which they are to take effect * * *. If there is a doubt as to the liability of an instrument to taxation, the construction is in favor of the exemption. * * *".

Application of the *Isham* principles as reaffirmed in *Leslie Salt* requires dealing only with the form and face of the instrument to determine the presence of the three features establishing taxability of a corporate security, the presence of each of which three features is essential, and each of which three features must be taken in the sense in which they are understood in the financial community. It is manifest from the form and face of petitioner's two instruments that they fail to meet the definition of "issued in series" as that term is used in financial parlance and therefore are

not marketable corporate securities as that term is generally understood.

The court below in its analysis of the affidavit submitted by petitioner, has ignored the expert testimony of the affiant that the two instruments are in fact not marketable corporate securities as that term is generally understood. Admittedly, a relatively small group of insurance companies and banks and others in a position to purchase a $30,000,00 instrument might constitute a market. Indeed, for a price, what item is not marketable as that term is understood by the court below? Petitioner submits that when this Court in *Leslie Salt* (390) qualified the term "marketable corporate securities" by adding "as that term is generally understood", it specifically anticipated and rejected the meaning given to the term by the court below (App. 20-21).

B. The only decision known to us on the same matter as the one here in issue that has been reported since *Leslie Salt* is *Standard Packaging Corporation v. United States of America*, 197 F. Supp. 788 (DC Minn. 1961). In his opinion Minnesota District Judge Dennis F. Donovan said (197 F. Supp. at 791): "The holder of the debentures had the option of requiring registration; *they were issued in series* and under a trust indenture and with acceleration of maturity in the event of default; and with the provision for certification, the debentures in suit were issued under the corporate seal. The foregoing undisputed facts, simply and concisely stated, present a difficult question of law for decision by the Court." (Emphasis supplied).

The Minnesota district court recognized that one of the essential features of a marketable corporate security as that term generally is understood is that it must be issued in series. The court below considered this feature of no

consequence (App. 17). Accordingly, a serious conflict exists between a district court in the Eighth Circuit and the court below, as to the meaning of and consequently the significance of an instrument being issued in series in determining whether it qualifies as a marketable corporate security as that term is generally understood and, so qualifying, is therefore subject to the stamp tax.

The ruling below is in conflict with the decision in *Anderson v. Akers*, 7 F. Supp. 924 (W.D. Ky., 1934); affirmed in part; reversed in part on other grounds; and remanded, 86 F. 2d 518 (CA-6, 1936). This case in part pertained to whether twenty-year first mortgage bonds of a manufacturing corporation acquired by a national bank, being part of a total issue of $750,000 in principal of such bonds, qualified as "investment securities" within a statute permitting the bank to hold such securities of any one obligor up to 25% of the bank's capital stock and surplus. The court found that the bonds did not meet the tests of marketability and therefore did not qualify as "investment securities". The court stated at page 944: "Obviously, these bonds were issued by the Murray Rubber Company in order to evidence its indebtedness to these two banks created by their advances just mentioned, and it seems plain that no public distribution of such bonds was made or contemplated."

Similarly, the two instruments here at issue were delivered to the two insurance companies by the petitioner in order to evidence its indebtedness to two insurance companies for the amount of the borrowing. Similarly, these two instruments do not meet the tests of marketability and therefore do not qualify as "investment securities". No public distribution of them has been made and it seems plain that none was contemplated. Indeed, petitioner's supporting affidavit contains a statement "that your depon-

ent knows of no instance where a portion of a 'closed-end' issue purchased privately by an institutional investor has subsequently been resold by such investor" (R. 183-184).

C. *Leslie Salt* holds that the tests to be applied in order to determine the taxability of an instrument under 1939 Internal Revenue Code sections 1800 and 1801 are:

(1) Is it issued (i) in series, (ii) under a trust indenture, and (iii) in registered form or with coupons attached?

(2) Is it a marketable corporate security as that term is generally understood?

The two instruments here at issue meet neither test. As discussed above and in the affidavit of petitioner's financial expert the two instruments are neither issued in series nor are they marketable corporate securities as those terms are generally understood. The ruling below ignores these tests so clearly laid down by this Court in *Leslie Salt*, substitutes its own variation of these tests, and by so doing injects uncertainty and inconsistency into the tax system.

Petitioner respectfully submits that this Court should exercise its power of supervision and decide (i) whether "issued in series" as one of the three requisite features of an investment security, has the meaning generally understood by the financial community and (ii) whether an instrument whose provisions, determinable from its form and face, fail to make it marketable as that term is generally understood by the financial community, is exempt from the "debenture" tax.

D. The tax here in question was imposed pursuant to 1939 Internal Revenue Code sections 1800 and 1801. The corresponding provisions of the 1954 Internal Revenue

Code applicable to this case are sections 4311 and 4381(a). As is shown in Appendix C, pp. 25-26, no change in substance has been made so far as the present case is concerned.

CONCLUSION

For the reasons set forth above, petitioner respectfully submits that this petition for a writ of certiorari should be granted.

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APPENDIX A

IN THE UNITED STATES COURT OF CLAIMS.

No. 58-60

(Decided June 7, 1963)

McLOUTH STEEL CORPORATION v. THE UNITED STATES

Ernest Gellhorn for plaintiff.

Conrad T. Hubner, Jr., with whom was *Assistant Attorney General Louis F. Oberdorfer*, for defendant. *Edward S. Smith, Lyle M. Turner, Philip R. Miller, John E. Palmer* and *Earl L. Huntington* were on the briefs.

Before JONES, *Chief Judge*, REED, Justice (Ret.), sitting by designation, LARAMORE, DURFEE and DAVIS, *Judges*.

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

REED, *Justice (Ret.)*, sitting by designation, delivered the opinion of the court:

Sections 1800, 1801 of the Internal Revenue Code of 1939 impose an ad valorem documentary stamp tax on "all bonds, debentures, or certificates of indebtedness issued by any corporation. . . ." We are called upon to determine

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[1] Sec. 1800. Imposition of Tax.

There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stocks and of indebtedness, and of other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, the several taxes specified in such sections.

(Continued on next page)

whether two instruments issued by the taxpayer in 1953 are bonds within the meaning of this statute.

The taxpayer, McLouth Steel Corporation, considered the instruments taxable in 1953, for it purchased and affixed the stamps at the time of their issuance. However, after the decision of the Supreme Court in *United States v. Leslie Salt Co.*, 350 U.S. 383 (1956), the taxpayer filed a claim for a refund, asserting that the instruments were not covered by the statute. The taxing authorities having rejected taxpayer's claim, the present action for a refund was filed in this court. The case is now before us on the Government's motion for a summary judgment.

The instruments in question are each labelled a "First Mortgage 4½% Sinking Fund Bond," and are identical in terms except as to amount and payee. One, with a face value of $30,000,000, and numbered No. R-0000001, was issued to the Metropolitan Life Insurance Company; the second, with a face value of $26,000,000, numbered No. R-0000002, was issued to The Prudential Insurance Company of America. They are issued in the name of the respective insurance companies and registered with the borrower, McLouth. The instruments are formal documents, printed on a steel engraved border, and issued under the seal of the taxpayer.

Each instrument has a maturity of 19½ years, and carries interest of 4½% on the unpaid balance, payable semi-annually. The instruments are each subject to the terms of both a "Purchase and Loan Agreement" executed between McLouth and the insurance companies, and an "Indenture

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"Sec. 1801. Corporate Securities.

On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents; * * *"

26 U.S.C. §§1800, 1801 (1952 ed.); compare Internal Revenue Code of 1954 §§4311, 4381, 26 U.S.C. §§4311, 4381 (1958 ed.).

of Mortgage and Deed of Trust" executed between McLouth and the National Bank of Detroit, as trustee. McLouth has the right to redeem the Bonds at any time upon the payment of a stipulated premium. The insurance companies have the right to demand that McLouth exchange their originally issued Sinking Fund Bonds in exchange for registered or coupon bonds in the same aggregate principal amount but in smaller denominations. The sinking fund provisions are set out in the indenture. Substantial restrictions upon McLouth's right to incur additional indebtedness and to pay dividends are also imposed by the indenture agreement.

Contemporaneously with the issuance of the above Sinking Fund Bonds, McLouth also borrowed an additional $4,000,000 from each of the two insurance companies, evidenced by "5¼% Income Convertible Notes," and $14,000,000 from certain banks, with the National Bank of Detroit as agent, under a "Bank Loan Agreement." The Sinking Fund Bonds and the bank loans are secured by property of the taxpayer under the indenture agreement, but the Income Convertible Notes are not covered by the indenture.

In the *Leslie Salt* case, the taxpayer had also borrowed large amounts from two insurance companies, giving to each a single instrument labelled "3½% Sinking Fund Promissory Notes." The Supreme Court there rejected the Government's position that because the Notes were "of large amounts, long maturity, and secured by an elaborate underlying agreement," they were taxable as either "debentures" or "certificates of indebtedness" under the stamp tax statute. In holding the Promissory Notes not subject to the tax, the Court suggested that the only such instruments to which the tax applies are those:

> "issued (1) in series, (2) under a trust indenture, and (3) in registered form or with coupons attached. In other words, that tax was considered to apply only to marketable corporate securities, as that term is generally understood." 350 U.S. at 389-90.

The Promissory Notes in *Leslie Salt* satisfied none of the three enumerated conditions. The Sinking Fund Bonds involved in the present case meet all three. The Promissory Notes were issued pursuant only to agreements between the issuer and the lender. The Bonds here were issued pursuant to a similar agreement, but also under an indenture with an independent trustee. The Promissory Notes were neither in registered form nor with coupons attached; the Bonds here are in registered form.

The Promissory Notes contained no serial number; the Bonds in this case do. Taxpayer correctly argues that the use of a serial number is not what is meant in financial parlance by an issue "in series." An issue of serial bonds is one in which certain (series) of the bonds automatically mature at given intervals; serial bonds are used as an alternative to sinking fund bonds as a method of insuring preparation for redemption prior to the maturity date of the issue.[2] Nonetheless, we cannot agree that the reference to "in series" in *Leslie Salt* was intended to adopt this technical distinction for purposes of the stamp tax. The administrative history of the statute, with reference to which the statement in *Leslie Salt* was made, indicates that it has been only the presence or absence of a serial number to which significance has heretofore been attached.[3] We see no

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[2] Guthmann & Dougall, Corporate Financial Policy 222-23 (4th ed. 1962); Dewing, Financial Policy of Corporations 249 (5th ed. 1953).

[3] In reference to the Revenue Act of 1917, c. 63, 40 Stat. 300, the Treasury ruled as follows:

"(3) Instruments containing the essential features of a promissory note, but issued by corporations *in numbers* under a trust indenture either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and sometimes for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes . . ." T.D. 2713, 20 Treasury Decisions 358, 359 (1918). (Emphasis added.)

(Continued on next page)

reason why sinking funds bonds should be immune from the documentary stamp tax, and none has been suggested to us. Hence, we attach some slight significance to the fact that the Bonds here were issued with serial numbers; but we deem it of no consequence that the Bonds were not issued serially.

Taxpayer's Sinking Fund Bonds thus contain all the normal features of a corporate bond,[4] and are distinguishable from the instruments in *Leslie Salt* in the three respects considered significant by the Supreme Court. Nonetheless, the taxpayer argues that the instruments are not taxable under the statute because they are not marketable. It is true that in *Leslie Salt* marketability was stated to be of prime importance—indeed, "[t]he essence of an 'investment security.'" 350 U.S. at 393. And see *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F. 2d 305, 311 (C.A. 2, 1954). But what meaning are we to give to "marketability" in this con-

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In the regulations to the Revenue Act of 1918, c. 18, 40 Stat. 1057, "in series" was substituted for "in numbers," though the latter phrase was retained in the caption to the regulation:

"Art. 8 Instruments issued by corporations *in numbers*, under a trust indenture, are bonds.—Instruments containing the essential features of a promissory note, but issued by corporations *in series*, secured by a trust indenture, either in registered form or with coupons attached embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and in some instances for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes." Treas. Reg. 55, Art. 8 (1919). (Emphasis added.)

The phrase was deleted altogether from later regulations, see Treas. Reg. 71, §113.55 (1941) but "in series" has been restored, in the regulations to the 1954 Code. Treas. Reg. §43.4381-1(a).

Compare United States v. Royal Loan Co., 61 F. Supp. 436 (E.D. Mo. 1945), aff'd 154 F. 2d 556 C.A. 8, 1946).

[4] As noted above, the Bonds also contain the usual title, formal appearance, and provisions of a corporate bond.

text? The Government argues that the Supreme Court's reference to marketability meant "only that an instrument which is to be made subject to the stamp tax should have on its face those formal incidents which are conducive to marketability or which are generally found on marketed instruments."[5] The taxpayer, on the other hand, asserts that the term should be given its "specific technical meaning," under which, according to the affidavit of its financial expert, the term applies to an issue "for which purchasers can be found at a price reasonably commensurate with the prices * * * at which evidences of indebtedness with similar maturity dates of other corporations are concurrently being marketed."[6]

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[5] The Government points out, inter alia, that the opinion in *Leslie Salt* dealt only with the three features discussed above, and gave no consideration to the factors taxpayer argues are subsumed under the head of marketability. Furthermore, it is argued that the statement in the opinion that "*in other words*" the tax applies only to marketable securities, made after listing these three features, suggests that an instrument containing these characteristics is necessarily marketable for purposes of the stamp tax.

[6] The affidavit reads in part as follows:

"4. [The affiant] represents that the term 'marketable' as applied to issues of evidences of indebtedness of industrial corporations, where the maturity of the indebtedness is to occur at a remote future date, has a specific technical meaning generally understood and accepted within the financial community and by persons involved in the securities business, to wit: a 'marketable' issue is one for which purchasers can be found at a price reasonably commensurate with the prices (expressed in yield to maturity) at which evidences of indebtedness with similar maturity dates of other corporations are concurrently being marketed, taking into account the many factors entering into the determination of the market values of the specific obligations of the respective corporations, including but not restricted to the following:

"a. Reputation of the borrower in the financial community at the time the borrowing takes place, including an assessment of the ability of the borrower to compete, and to continue to compete for an extended future period, on profitable terms, in the business or businesses in which it is engaged;

(*Continued on next page*)

We cannot agree with taxpayer that an instrument otherwise a bond is not subject to the stamp tax because it can be sold, or resold, only at a substantial discount. It was stated in the early case of *United States v. Isham*, 17 Wall. 496, 504 (1873), and reaffirmed in *Leslie Salt*, 350 U.S. at 396, that "[t]he liability of an instrument to a stamp duty, as well as the amount of such duty, is determined by the form and face of the instrument, and cannot be affected by proof of facts outside of the instrument itself." See

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"b. Dollar size of the obligations being placed on the market in relation to the amount of funds available in the market for investment in obligations of the type being marketed;

"c. The type of obligation and the relative amounts of senior, parity and junior instruments to be outstanding on completion of the financing, especially the amount of equity securities then to be outstanding;

"d. Adequacy of the restrictive provisions in the indenture underlying the issue, including but not restricted to:

(1) The reasonableness of the provisions permitting the corporation to issue and sell additional pari passu evidences of indebtedness within limits in the future, in order to facilitate the financing of requirements for new funds arising from technological developments within the industry or from growth in demand for products or services resulting from increased population or other development, such provisions usually taking the form of the discretionary issuance of additional obligations, in series with differing maturities, interest rates, sinking fund provisions and redemption features for each series, under indentures supplemental to and permitted by the underlying indenture and providing with respect to secured obligations that the amount of additional indebtedness permitted under the underlying indenture shall not exceed a given percentage, say 66⅔%, of net additions to property, and with respect to unsecured obligations that the amount of additional indebtedness shall meet certain asset and/or earnings tests, such issues generally being referred to as "open-end" issues; and

(2) The reasonableness of the provisions, if any, limiting the payment of dividends on stock and the purchase and retirement of instruments ranking junior to the obligations issued under the indenture, the objective generally, being to prevent the directors of the corporation from diluting the proportion of equity underlying the obligations but to permit the payment of dividends in reasonable amounts so as not to impair the value in the market of the stocks of the corporation in relation to the values of the stocks of competing corporations, other factors being equal."

also *Ledoux v. Fidelity Trust Co.*, 267 U.S. 17 (1925). The taxpayer's affidavit recognizes that to evaluate marketability as therein defined, it would be necessary to consider such facts as those bearing on the financial reputation of the borrower; yet we can conceive of no example more at odds with the rule of *Isham*. Taxpayer predicates lack of marketability in this case primarily on the size of the two Bonds involved.[1] Admittedly the amount of indebtedness represented by each Bond can be determined from the "face" of the instrument. But size alone has no bearing on the taxability of an instrument. *Niles-Bement-Pond Co. v. Fitzpatrick*, *supra*, at 310; *Belden Mfg. Co. v. Jarecki*, 192 F. 2d 211, 214 (C.A. 7, 1951). And were we to consider the extent to which the amount of the Bonds affects the ability of the holder to sell them at a price approximating their face value, we would be required to hear and evaluate evidence going far beyond the terms of the instrument.

Moreover, although there are of course more possible buyers for one thousand dollar than for thirty million dollar bonds, that is not to say that the relatively small group of insurance companies and banks and others in a position

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[1] The affiant also suggests a second reason which we think insupportable in any event. The affiant emphasizes that under the terms of the indenture Melouth's ability to borrow is so restricted that it will be unable to satisfy its probable future capital requirements without obtaining the consent of all parties protected by the indenture (or by redeeming the Bonds). The necessity for unanimity furnishes "the initial holders of the two instruments with strong incentive not to broaden the number of holders through sale of a portion of their holdings," and, similarly, "the considerations deterring an initial holder from attempting the resale of a portion of its holdings would also deter a prospective purchaser from purchasing the obligations at a price commensurate with its value to the initial holder." But at most this tends to show only that if the present instruments were split into smaller denominations, the resulting instruments might not be marketable. It does not contradict the fact that when the number of holders is small, the restrictive provisions tend to protect the bondholders and thus increase the worth of the Bonds. Though discouraging a sale of *a portion* of the issue, the restrictive provisions increase the marketability of the single Bonds to any purchaser large enough to consider such an investment.

to purchase the latter do not constitute a market for such instruments. How large an interested group of purchasers does taxpayer suggest would be necessary before an instrument could be deemed marketable? Or how much of a discount would the seller have to bear to render it unmarketable? We do not believe that the applicability of the stamp tax can be permitted to turn on the answer to such questions as these. Compare *Standard Packaging Corp. v. United States*, 197 F. Supp. 788 (D. Minn. 1961); *Georg Jensen, Inc. v. United States*, 173 F. Supp. 762 (S.D. N.Y. 1959), rev'd on other grounds, 275 F. 2d 956, on rehearing 279 F. 2d 870 (C.A. 2, 1960).

Rather, in holding the taxpayer's Sinking Fund Bonds to be taxable as bonds within the meaning of the statute, we lay particular stress on the existence of the indenture and the independent trustee, the National Bank of Detroit. The presence of an indenture and trustee is commonly regarded as differentiating a bond from a promissory note. The latter is a two-party agreement, whereas the presence of a trustee brings a third party into the transaction. Promissory notes are ordinarily used "when there is a private deal and only one or a very few investors." Childs, Long-Term Financing 119. On the other hand, an indenture and a trustee are normally used in connection with an issue which is designed to be widely traded, in order to safeguard the rights of many holders who are often unable effectively to protect themselves, and to eliminate the necessity for a separate contract each time the bond is traded. Id., at 91-93; Guthmann & Dougall, supra, at 170-71, 176-77; Baker & Cary, Cases on Corporations 1016 (3d ed. 1959); compare Berle & Warren, Cases on Business Organization 862. Because an instrument issued under an indenture is normally designed for marketing to the public when an indenture and trustee accompany the other features found in the instruments here under scrutiny, the instrument will normally be a corporate security as that term is generally understood. This may not invariably be true, but taxpayer has pointed to nothing sufficient to render this generalization inapplicable to the instruments involved in the present case.

For the reasons stated, we hold that the two Sinking Fund Bonds are subject to the stamp tax, and that the Government's motion for summary judgment must be granted. Plaintiff's petition is therefore dismissed.

APPENDIX B

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

Sec. 1800. "There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and of other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, the several taxes specified in such sections." 26 U.S.C. 1952 ed. §1800.

Sec. 1801. "On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents; * * *" 26 U.S.C. 1952 ed. §1801.

Treasury Regulations 71 (1941 ed.):

Sec. 113.50. "Scope of tax. Section 1801 imposes a tax upon the issue by any corporation of bonds, debentures, certificates of indebtedness, and all instruments, however termed, with interest coupons or in registered form and known generally as corporate securities. Every renewal of the above described instruments is taxable as a new issue."

Sec. 113.55. "Issues subject to tax. Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument,

however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration, and coming within the class known generally as corporate securities will be held subject to the tax regardless of the name by which it may be called." 26 CFR, 1944 Cum. Supp., §§ 113.50, 113.55.

APPENDIX C

CORRESPONDING PROVISIONS OF 1954 INTERNAL CODE AND REGULATIONS

Internal Revenue Code of 1954:

Sec. 4311. "There is hereby imposed, on all certificates of indebtedness issued by a corporation, a tax at the rate of 11 cents on each $100 of face value or fraction thereof." 26 U.S.C. 1958 ed. §4311.

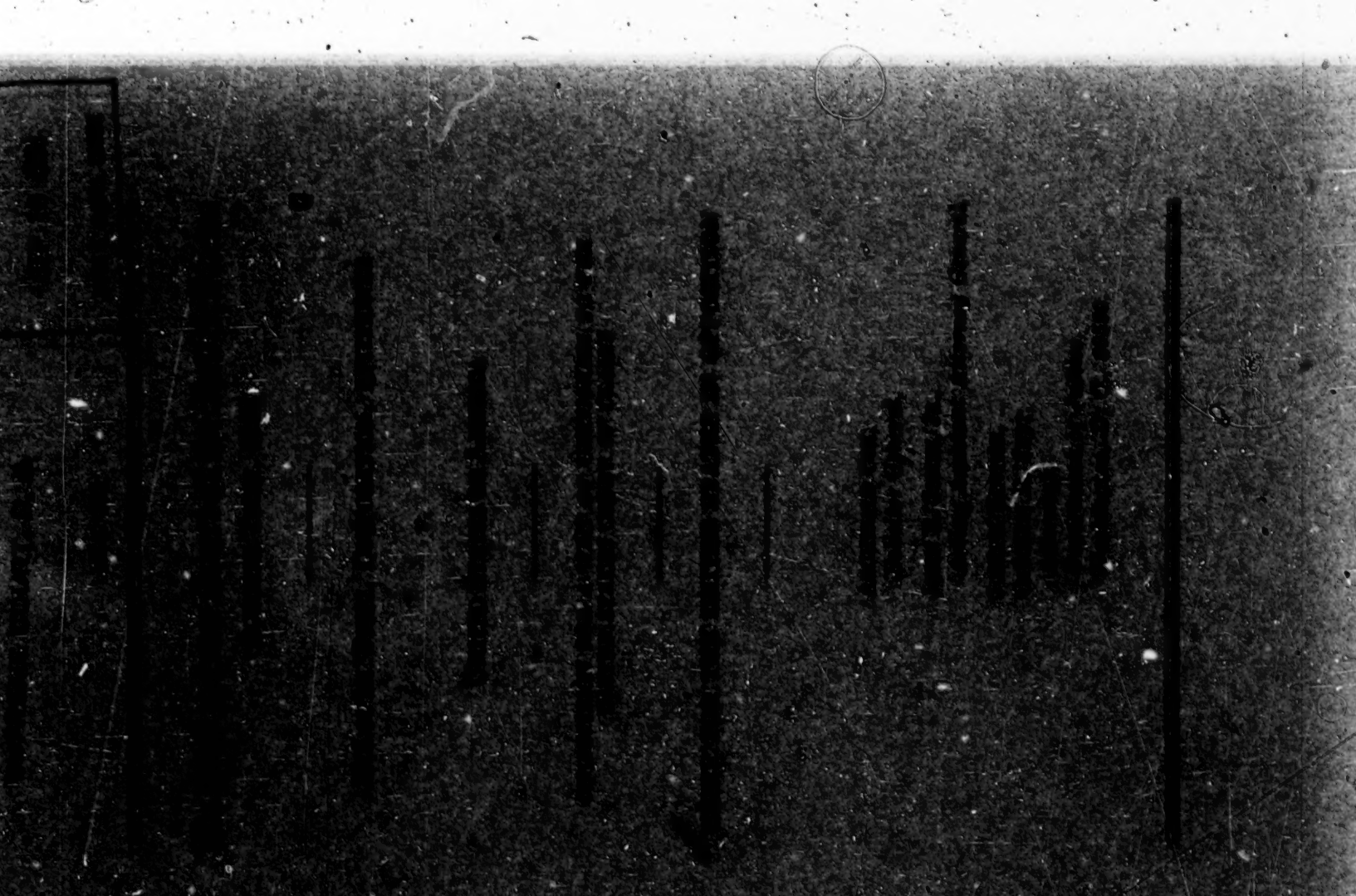
Sec. 4381(a). "Certificates of indebtedness. For purposes of the taxes imposed by sections 4311 and 4331, the term 'certificates of indebtedness' means bonds, debentures, or certificates of indebtedness; and includes all instruments, however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities." 26 U.S.C. 1958 ed. §4381(a).

Treasury Regulations:

Sec. 47.4311-1(a). "Scope of tax. Section 4311 imposes a tax on the issue within the territorial jurisdiction of the United States by any corporation of certificates of indebtedness as defined in section 4381(a) and paragraph (a) of §47.4284-1. * * *" 26 CFR, 1963 Cum. Supp. 104, §47.4311-1(a).

Sec. 47.4381-1(a). "Certificates of indebtedness. The term 'certificates of indebtedness' includes bonds, debentures, and certificates of indebtedness. Such term also includes all instruments, however termed, issued by a corporation with interest coupons or in registered form and known generally as corporate securities. The essence of a corporate security is marketability. An instrument is ordinarily considered to be marketable if it is issued in series, under a trust indenture, and in registered form or with interest coupons attached. For example, an instrument

containing the essential features of a promissory note is included within the meaning of the term 'certificates of indebtedness' if it has, in addition, the general characteristics of a corporate security. Whether or not an instrument is a certificate of indebtedness within the meaning of section 4381(a) is not determined by its name alone, but depends upon all the facts which can be derived from the face of the instrument, such as the form and terms of the instrument. The nature of the transaction or any fact appearing outside of the instrument itself is immaterial for purposes of making such determination." 26 CFR, 1963 Cum. Supp. 127. 47.4381-1(a).



In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 393

MCLOUTH STEEL CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 255-262, Pet. 13-22), is reported at 319 F.2d 167.

JURISDICTION

The judgment of the Court of Claims was entered June 7, 1963. (R. 255, 262, Pet. 13, 22.) The petition for a writ of certiorari was filed on August 22, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

In 1953 the taxpayer issued and sold to two insurance companies two "First Mortgage 4¼% Sinking Fund Bonds" totalling $56,000,000, which were in registered form, numbered serially, issued under a purchase and loan agreement, and secured by property of the taxpayer under a trust indenture with an independent trustee. The question presented is whether the instruments are subject to the documentary stamp tax imposed by Sections 1800 and 1801 of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

> SEC. 1800. IMPOSITION OF TAX.
>
> There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters or things, or any of them, are written or printed, the several taxes specified in such sections.
>
> SEC. 1801. [As amended by Sec. 521(a)(3) of the Revenue Act of 1941, c. 412, 55 Stat. 687, 706.] CORPORATE SECURITIES.
>
> On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered

form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue * * *.

Treasury Regulations 71 (1941 ed.):

SEC. 113.50. *Scope of Tax.*—Section 1801 imposes a tax upon the issue by any corporation of bonds, debentures, certificates of indebtedness, and all instruments, however termed, with interest coupons or in registered form and known generally as corporate securities. Every renewal of the above described instruments is taxable as a new issue.

SEC. 113.55. *Issues Subject to Tax.*—Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration, and coming within the class known generally as corporate securities will be held subject to the tax regardless of the name by which it may be called.

* * * *

STATEMENT

The undisputed facts are summarized by the court below (Pet. 13-15) as follows:

On or about June 25, 1953, the taxpayer borrowed a large amount of money with the intent of expanding its steel production facilities. The larger portion of this debt was evidenced by two instruments each labelled a "First Mortgage 4¼% Sinking Fund Bond", identical in terms except as to amount and payee: one, with a face value of $30,000,000 numbered No. R 000001, was issued to the Metropolitan Life Insurance Company; the other, with a face value of $26,000,000, numbered No. R 000002, was issued to the Prudential Insurance Company of America. They were issued in the name of the respective insurance companies and registered with the borrower, McLouth. The instruments are formal documents, printed on a steel engraved border; and issued under the seal of the taxpayer.[1] (Pet. 14.)

Each instrument has a maturity of 19½ years and carries interest of 4¼% on the unpaid balance, payable semi-annually. Each of these bonds was sold under a purchase and loan agreement executed between the taxpayer and the insurance companies, the agreements being identical except for the name of the insurance company and the amount of the debt. (R. 5-18.) The bonds were secured by property of the taxpayer under an "Indenture of Mortgage and Deed of Trust", executed between the taxpayer and the National Bank of Detroit, as trustee. The taxpayer has the right to redeem the bonds at any time upon the payment of a stipulated premium. The insurance companies have the right to demand that the taxpayer

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[1] A facsimile of the two bonds is found at R. 44-47.

exchange their originally issued Sinking Fund Bonds for registered or coupon bonds in the same aggregate principal amount but in smaller denominations. The indenture agreement sets forth the sinking fund provisions and imposes substantial restrictions upon the taxpayer's right to incur additional indebtedness and to pay dividends. (Pet. 14-15.)

At the time of the issuance of the instruments in 1953, the taxpayer purchased and affixed stamps in the aggregate amount of $61,600. However, after the decision of the Supreme Court in *United States* v. *Leslie Salt Co.*, 350 U.S. 383 (1956), the taxpayer brought suit for a refund, asserting that the instruments were not covered by the statute. (Pet. 14.) The court below (per Reed, J.) granted the government's motion for summary judgment, holding that the taxpayer's Sinking Fund Bonds contain all the normal features of a corporate bond, in addition to the usual title, formal appearance and provisions, and, therefore, that the taxpayer's Sinking Fund Bonds were taxable as "bonds" and as "corporate securities" within the meaning of Sections 1800 and 1801 of the Internal Revenue Code of 1939. (Pet. 13-22.)

ARGUMENT

The decision below is correct. There is no conflict or other reason warranting further review.

The evidences of indebtedness in this case are in form and substance corporate bonds, plainly subject to the stamp tax under the literal terms of the statute imposing the tax upon "all bonds * * * issued by any

corporation".[2] The taxpayer's reliance upon *United States* v. *Leslie Salt Co.*, 350 U.S. 383, is misplaced, since that case involved an instrument in the form of a promissory note, which this Court held was within the exemption of promissory notes from the documentary stamp tax. The taxpayer's contention that the stamp tax does not apply to corporate bonds unless they are one of a series of bonds issued under an open-end indenture, has no basis in the statute, the Regulations, or the *Leslie Salt* decision. The fact that corporate obligations issued in such large denominations are not readily marketable is not relevant in the case of a bond which is on its face a marketable instrument. *United States* v. *Isham*, 17 Wall. 496.

The taxpayer's claim of conflict is wholly without substance. *Standard Packaging Corp.* v. *United States*, 197 F. Supp. 788 (Minn.), is a district court decision holding a debenture subject to tax, while *Anderson* v. *Akers*, 7 F. Supp. 924 (W.D. Ky.), affirmed in part and reversed in part sub nom. *Atherton* v. *Anderson*, 86 F. 2d 518 (C.A. 6), involved a wholly different question of whether bonds were legal investments for a national bank. Cf. *United States* v. *Regal Loan Co.*, 61 F. Supp. 436 (E.D. Mo.), affirmed, 154 F. 2d 556 (C.A. 8).

The issue lacks importance, since it is confined to the tax on the issuance of corporate obligations in the form of a bond purchased by large investors before the *Leslie Salt* decision. Since that decision, most

[2] The court below found that the instruments were also within the statutory description of corporate securities.

loans privately placed have been cast in the form of promissory notes.

CONCLUSION

For the reasons stated, the taxpayer's petition for certiorari should be denied.

Respectfully submitted.

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Acting Assistant Attorney General.

JOSEPH KOVNER,
CAROLYN R. JUST,
Attorneys.

SEPTEMBER, 1963.

The Internal Revenue Service informally advises us that there are now no pending cases involving documentary stamp taxes on corporate bonds issued after the *Leslie Salt* decision (1956). According to data furnished by the Securities and Exchange Commission, for the year 1960, of the 968 debt issues for which the Securities and Exchange Commission had records of whether or not the documentary stamp tax had been paid, 684 of the issues were called notes. A documentary stamp tax was paid on only about 25 percent of the 968 debt issues. The total proceeds of the instruments entitled promissory notes which were issued in 1960 and for which the Securities and Exchange Commission had records of payment or non-payment of the documentary stamp tax was 2.28 billion dollars and of this no documentary stamp tax was paid on 2.193 billion dollars of instruments.

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